

BEFORE THE STATE TAX APPEAL BOARD  
OF THE STATE OF MONTANA

-----

SEAN M. PATTEN,	)	
	)	DOCKET NO.: IT-2003-4
Appellant,	)	
	)	
-vs-	)	FACTUAL BACKGROUND,
	)	CONCLUSIONS OF LAW,
THE DEPARTMENT OF REVENUE	)	ORDER and OPPORTUNITY
OF THE STATE OF MONTANA,	)	<u>FOR JUDICIAL REVIEW</u>
	)	
Respondent.	)	

-----

The above-entitled appeal was heard on April 13, 2004, in the City of Bozeman, Montana, in accordance with an order of the State Tax Appeal Board of the State of Montana (the Board). The notice of the hearing was duly given as required by law.

The taxpayer, Sean M. Patten, presented testimony in support of the appeal. The Department of Revenue (DOR), represented by Ms. Sylvia Headley, field auditor, Region 4, Missoula, and Douglas Peterson, field audit manager, presented testimony in opposition to the appeal. In addition to testimony, exhibits were received in evidence. Mr. Patten is the appellant in this proceeding and, therefore, has the burden of proof. Based on the evidence, this Board finds as follows:

### **STATEMENT OF THE ISSUE**

The issue in this matter is whether the taxpayer should be allowed to deduct losses claimed on his 1998 Montana individual tax return, resulting from a South Dakota sub-chapter S corporation. The DOR contends that the rental loss was derived from property not owned by the taxpayer. In addition, said sub-chapter S losses are not allowable because the corporation did not file a tax return for 1998.

### **FACTUAL BACKGROUND**

1. Due, proper and sufficient notice was given of this matter, the hearing hereon, and of the time and place of the hearing. All parties were afforded the opportunity to present evidence, oral and documentary.

2. This issue was appealed to the DOR and to this Board for tax years 1997 and 1998. This Board upheld the DOR determination to deny the losses claimed by the taxpayer.

3. Mr. Patten is a shareholder in BMP Corporation. A Schedule K-1 issued by the corporation indicates that, during 1998, Mr. Patten's shareholder percentage of stock ownership was eighteen percent.

4. BPM is a South Dakota corporation.

5. BPM Corporation is not registered to conduct business in Montana and was not when the taxpayer's return was filed.

6. At the time of the hearing before this Board, BPM had not filed a corporate tax return with the Montana DOR for 1998.

7. Copies of records submitted by the DOR and the taxpayer show that John and Leigh Patten purchased Lots 9 and 10, Block 13, of the Butte Addition, Bozeman, Montana, on October 23, 1987. Said property is commonly referred to as 1120 South Willson, Bozeman, Montana.

8. A warranty deed, dated January 19, 1990, filed in Gallatin County, conveyed the interest of John and Leigh Patten in the 1120 Willson property to BPM Corporation.

9. A quitclaim deed, dated January 8, 1998, filed in Gallatin County, relinquished any claim of ownership of the 1120 South Willson property from BPM Corporation to Sean Patten.

10. A quitclaim deed, dated July 9, 1998, in Gallatin County, relinquished any claim of ownership from Sean Patten in the 1120 South Willson property to BPM Corporation.

11. In a document dated January 3, 1993, Sean Patten and BPM Corporation entered into an agreement in which the corporation assigned all income from the rental of its South Willson property to Sean Patten. In exchange, Mr. Patten was to manage the property, as well as supply all material and labor necessary to operate and maintain the property. Mr. Patten testified he had managed the rental property.

12. A quitclaim deed was filed in Gallatin County on May 2, 2003, wherein BPM Corporation quit its claim to the 1120 South Willson property and conveyed it to Sean Patten.

13. On May 2, 2003, a realty transfer certificate was filed conveying the property from BPM Corporation to Sean Patten. Mr. Patten indicated that this document was filed to correct previous recording errors and to convey the ownership intent of BPM Corporation.

14. The taxpayer timely filed his 1998 Montana individual income tax return. On this return, Mr. Patten claimed his share of the corporation losses: \$7,639.20, resulting from the rental activities of the 1120 South Willson property.

15. A special property tax assessment for fiscal year 1998 lists the owner of record of the 1120 South Willson property as BPM Corporation (DOR Exhibit P)

16. A hearing was held on this matter on May 5, 2003 in Helena, Montana before Patrick McKenna, DOR hearing examiner.

17. On July 9, 2003 the hearing examiner issued his decision on the matter finding that the DOR properly disallowed the Taxpayer's claimed sub-chapter S corporation losses on his 1998 tax return.

18. The taxpayer filed a timely appeal to this Board on August 12, 2003.

19. The Board has jurisdiction over this matter in accordance with Section 15-2-302, MCA.

#### **TAXPAYER'S CONTENTIONS**

Mr. Patten contends he is entitled to the loss in question because he owned the Bozeman rental property on South Wilson during the tax year in dispute and that the sub-chapter S corporation, BPM Corporation, which is a South Dakota corporation, was never engaged in business in Montana and thus not required to file a Montana tax return for 1998.

In addition, Mr. Patten objects to the DOR's partial

adjustment to a tax refund he received for tax year 1998.

Mr. Patten criticized the DOR's demeanor toward him during his hearing before the DOR's Office of Dispute Resolution. These proceedings were intimidating and expensive to him. He claimed that the DOR brought up the subject of a missing Schedule E to impugn and attack his character.

Mr. Patten acknowledged that "they may have made some clerical errors" regarding the convoluted transfer ownership history of the 1120 South Willson property. (Taxpayer's Exhibit #4).

Mr. Patten also argued that BPM Corporation did no business in Montana during the years at issue and, thus, was not required to file a Montana tax return.

#### **DOR'S CONTENTIONS**

DOR, on the other hand, contends that Mr. Patten, the Taxpayer, did not own the Bozeman property during the tax year in question and that, in fact, the sub-chapter S corporation, BPM Corporation, owned the property. Further, BPM Corporation was engaged in the rental business in Montana at this time and was therefore required to file appropriate tax returns in Montana reporting gains or losses

from the rental activity. (Sections 15-31-101 (3) and 15-31-111(1), MCA.

At the time of the hearing before this Board, BPM had not filed a tax return for 1998. All of the net loss was, instead, reported by Sean Patten on his individual income tax return. Having determined that BPM Corporation was engaged in business in Montana in 1998, and therefore required to file Montana tax returns, the DOR disallowed the taxpayer's share of the sub-chapter S loss claimed on his 1998 individual income tax return. Since BPM has not filed a Montana return for 1998, no losses from the corporation can be deducted on the individual income tax return as a pass-through loss for those years. Corporate income or loss is passed through to each shareholder according to each shareholder's percentage of ownership. That pro rata share for each shareholder is then reported on the individual's return pursuant to Section 15-30-111, MCA. However, a loss will not be allowed on a Montana individual income tax return of a partner or shareholder unless ... a Sub "S" Corporation return is filed (Section 15-30-1101, MCA).

#### **BOARD'S DISCUSSION**

As stated above, the issue in this matter is whether

the Taxpayer should be allowed to deduct subchapter S corporation losses resulting from rental activity on his 1998 Montana individual income tax return. As in the prior appeal (IT-2000-3), the key to who gets to claim the rental activity loss depends on who owned the Bozeman property at the time in question. Following the September 1987 acquisition of the Bozeman property by the Taxpayer's parents by warranty deed, a number of related party transfers occurred. On September 14, 1988 the Taxpayer's parents transferred the property to him by quitclaim deed. Then, on January 19, 1990 the taxpayer's parents transferred the property to BPM Corporation by warranty deed. On January 8, 1998 BPM Corporation transferred the property to the taxpayer by quitclaim deed which was signed by the taxpayer as President of BPM Corporation. On July 9, 1998, the taxpayer transferred the property back to BPM Corporation by quitclaim deed. It was not until 2003 that actions were taken (the filing of a May 2003 realty transfer certificate transferring the property from BPM Corporation to Sean Patten) to "correct previous clerical errors", in Sean Patten's words, regarding the transfer of this property.



The Board regrets the immense amount of time and effort Mr. Patten and family have had to undertake to demonstrate the family's intent regarding ownership of this property.

However, the overwhelming evidence again demonstrates that BPM Corporation owned the property in question during 1998. Since the owner was BPM Corporation, it was properly considered to be in the rental business in Montana and therefore required to file appropriate Montana tax returns for the year in question. It did not and, in fact, has never filed a tax return in Montana. Thus, the sub-chapter S losses were properly disallowed.

#### **CONCLUSIONS OF LAW**

1. Section 15-2-302, MCA. Direct appeal from department decision to state tax appeal board - hearing. (2)(a) Except as provided in subsection (2)(b), the appeal is made by filing a complaint with the board within 30 days following receipt of notice of the department's final decision.
2. Income from rent is included in gross income. 26 U.S.C. § 61 (a)(5).
3. A small business corporation engaged in business in Montana is required to file a corporate license tax

return. Sections 15-31-111 and 15-30-1101 MCA.

4. A loss is not allowed on a Montana individual income tax return of a small business corporation shareholder unless the corporation files a corporate tax return as required by Section 15-30-1101, MCA.
5. Sean Patten v. Department of Revenue, IT-2003-3, Montana State Tax Appeal Board decision dated October 29, 2001.
6. The appeal of the taxpayer is hereby denied and the decision of the Department of Revenue upheld.

//

//

//

//

//

//

#### **ORDER**

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the tax, penalty and interest assessed by the DOR are properly due and owing for tax year 1998.

DATED this 23rd day of April, 2004.

BY ORDER OF THE  
STATE TAX APPEAL BOARD

( S E A L )

---

GREGORY A. THORNQUIST, Chairman

---

JEREANN NELSON, Member

---

JOE R. ROBERTS, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that on this 23rd day of April, 2004, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as

follows:

Sean M. Patten  
2107 Highland Court  
Bozeman, MT 59715

Office of Legal Affairs  
Department of Revenue  
Mitchell Building  
Helena, MT 59620

Sylvia Headley  
Auditor  
Compliance, Valuation, and Resolution Process  
Montana Department of Revenue  
1610 South 3<sup>rd</sup> Street West #105  
Missoula, MT 59801

---

DONNA EUBANK  
Paralegal